

OPERATING BUDGET REVIEW

Agenda Item E-1
September 18, 2000

The Council, at its July 17 meeting, adopted a recommendation calling for a review of the operating budget guidelines used in developing the Council's 2000-02 budget recommendation. The Council's action directed the Finance Committee to conduct the review. In addition, the Council has requested that the Strategic Committee on Postsecondary Education (SCOPE) establish a subcommittee to advise the Council during this review process. SCOPE will convene on Wednesday, September 6, to consider the Council's request.

The major issues that surfaced during the 2000 legislative session include:

1. Benchmark System
 - A. Development Process
 - B. Base/55th Percentile
2. Operating Incentives
 - A. Trust Funds
 - B. Special Initiatives
3. Capital
 - A. Space Planning Guidelines
 - B. Research Space

Attached is a brief review of each of these issues to help frame the discussion within the Council's Finance Committee and the SCOPE subcommittee.

Staff Preparation by Ron Carson, Dennis Taulbee,
Norma Northern (KYVU), Daniel Rabuzzi, Sherron
Jackson, and Billie Hardin

Issue 1: Benchmark System

A. Development Process

Criticism:

Institutions were not sufficiently involved in the benchmark development process.

Discussion:

The following chronology outlines the steps taken in developing and implementing the benchmark funding process.

- In late December 1998 and early January 1999, the CPE Finance staff developed a proposal outlining the benchmark funding process. This process was necessary because HB 1 did away with the funding formula that was used to develop biennial operating budget recommendations.
- At the January 21, 1999, meeting of institutional presidents with the Council president, the proposed benchmark funding process was presented. There was a discussion of the process at that session, and the presidents were asked to appoint institutional staff to serve on a work group to develop the process and to review the selection criteria.
- Also as a result of the presidents' meeting, a draft sample of the selection criteria and resulting list of benchmark institutions for a sample institution, the University of Louisville, was communicated on January 29, 1999.
- The first meeting of the benchmark process work group was held on February 10, 1999. Representatives from all institutions, except Morehead State University, were in attendance as were representatives from the Governor's Office for Policy and Management and the Legislative Research Commission.
- Changes made to the selection criteria as a result of that meeting were:
 - Two lists were prepared – one using percentages, one using absolute numbers.
 - Public service was added as a selection criterion.
 - Tenured faculty was added as a selection criterion.
- A follow-up meeting of the work group was held on February 24, 1999, to review the results of the changes made to the selection criteria.
- On March 1, 1999, the Council president made a presentation on the operating funding guidelines to the joint meeting of the Subcommittee on Postsecondary Education of the Interim

Committee on Education and the Budget Review Subcommittee on Education of the Interim Appropriations and Revenue Committee.

- At the March 3, 1999, presidents' meeting, the alterations recommended by the work group were discussed and the presidents requested that a student/faculty ratio criterion be added.
- On March 8, 1999, the work group members were sent revised benchmark institution lists reflecting the work group's and presidents' changes.
- On March 10, 1999, revised lists of 50 or fewer institutions were sent to the presidents along with a request for scheduling the next phase of the benchmark process. Accompanying correspondence indicated that discussion would ensue, and the institutions could propose to replace one or more of the top institutions from others further down on the list but their proposals had to be data driven.
- Benchmark funding guidelines were presented to the CPE Finance Committee as a discussion item at its March 15, 1999, meeting.
- Throughout the remainder of March and April, individual institutional meetings were held to reach agreement on final benchmark lists.
- The benchmark funding guidelines were approved by the Council at its April 12, 1999, meeting.
- On April 14, 1999, the Council president briefed SCOPE on the Council's proposed benchmark analysis approach to making an operating budget recommendation for the 2000-02 biennium.
- The benchmark institution lists for all Kentucky public institutions were taken to the May 17, 1999, Council meeting. The Council also directed its staff to proceed with the next steps in the funding guidelines process:
 - Complete the analysis of the public funds support per full-time equivalent student.
 - Establish the percentile funding objective to serve as the basis for the base funding request.
 - Determine and recommend the schedule for achieving the funding objective.
- The public funds per FTE student calculation was presented to the Council at its July 19, 1999, meeting and the Council established the 55th percentile as the benchmark funding objective. The agenda item included the next steps that would be taken to adjust the funding objective amounts from 1996-97 figures to the 1999-2000 base figures used in the 2000-02 biennial request.
- On August 2, 1999, the Council president briefed the Interim Joint Committee on Education on the funding guidelines process.

- On August 13, 1999, the Council president forwarded a communication to the presidents indicating that some institutional staff might be calculating the effects of the benchmarking process differently than Council staff. The elements included in his correspondence were:
 - The latest Integrated Postsecondary Education Data System data available were for 1996-97 and these numbers would have to be advanced to 1999-2000. The gap between an institution and the 55th percentile in 1996-97 should not be assumed to remain constant through succeeding years.
 - Council staff was including all the 1999-2000 appropriations for an institution regardless of where the funding appeared in the budget bill, including both debt service and incentive trust funds. However, endowment funds were excluded from any calculations.
 - Institutions were reminded that the funding per student in 1996-97 included both General Fund and tuition and fees revenue. Therefore, institutions could not simply multiply the gap amount by the FTE number to compute the implications of benchmarking. Tuition and fees must be deducted from a calculated 1999-2000 gap. Current year tuition and fee rates would be used for all institutions except Northern Kentucky University, which was disproportionately dependent upon tuition and fee revenue.
 - Council staff would include funding from the 2000-02 incentive trust funds as part of the way by which all institutions would have the opportunity to achieve funding at the 55th percentile of the benchmark groups.
 - The presidents were notified that the gaps might be smaller than their institutional staffs may have led them to expect and were informed that the Council had not yet decided over how many years it would recommend a plan to remove the gaps. Part of the money to close the gaps would be included in the incentive trust funds to which each institution would have access for amounts that are not guaranteed.
 - Institutional finance officers of the institutions received copies of this correspondence.
- At the September 1, 1999, meeting of SCOPE, the Council president provided an update on the new funding guidelines and gave a progress report on the Council's budget recommendation.
- At the October 6, 1999, meeting of the presidents, they received a benchmark funding summary showing the total 1999-2000 state appropriation number used in the benchmark funding calculation and the total dollar increase and corresponding percentage increase in state appropriation resulting from the application of the benchmark funding process for both fiscal years 2000-01 and 2001-02.
- On October 11, 1999, the Council Finance Committee held a budget hearing at which all institutions were given the opportunity to make twenty minute presentations to discuss their constituencies' interests in the Council's postsecondary education budget recommendation.
- On November 8, 1999, the Council approved the 2000-02 funding recommendations for postsecondary education. The institutional presidents were asked to make comments on the

recommendation prior to the Finance Committee's approval. No presidents commented on the benchmark funding recommendations.

- On November 29, 1999, the Council president briefed SCOPE on the Council-approved 2000-02 budget recommendation.

Issue 1: Benchmark System

B. Base / 55th Percentile

Criticisms:

- 1) Funding for certain types of university activities—for instance, debt service, health science centers, agriculture research, and public service programs—should have been excluded from the benchmark analysis.
- 2) A rational determination of 1999-2000 funding levels for benchmark institutions could not be made because current funding data for institutions in other states were not available.
- 3) There was too much variation in funding levels among benchmark groups for Kentucky institutions with similar profiles.
- 4) There was no rational basis for the selection of the 55th percentile funding target.
- 5) It was not clear “what counted” in the dollar amount that was used to compare Kentucky institutions to the 55th percentile.

Discussion:

- 1) The funding system used to build the 2000-02 budget recommendation benchmarks Kentucky’s institutions with similar institutions in other states using a set of 15 criteria to determine “likeness.” The benchmarks are “whole” institutions. For this reason, the benchmark system did not break out internal line-item allocations for debt service or any other specific campus activities. It preserves Kentucky’s historical commitment to lump-sum appropriations for its postsecondary institutions.
- 2) The most recent data available through the Integrated Postsecondary Education Data System (IPEDS) was 1996-97 data. To compensate for the unavailability of more current information, the Council adjusted the 1996-97 funding levels by the base percentage increases provided in Kentucky budgets over that period – 2 percent, 2.9 percent, and 2.8 percent, respectively. The use of a CPI-related factor was considered but was not used because it would have resulted in lower increases.
- 3) Variations do exist among the benchmark institution groups. Funding levels were, by design, not part of the selection criteria in identifying benchmark institutions. Because the purpose of the benchmark system was to help determine adequate levels of funding for Kentucky’s

institutions relative to similar ones in other states, using funding as a selection criterion would have defeated the purpose.

- 4) The 55th percentile was selected as the appropriate funding target because the Council wanted Kentucky's institutions to be funded at a level slightly higher than the mid-point among their respective benchmarks. In addition, the recommendation to fund at the 55th percentile over a three-year period generated what the Council believed to be a reasonable increase that the state could afford. The Council did not want the new benchmark funding system to be viewed as the previous funding formula was – so expensive that it became irrelevant to the process. Finally, the Council sought a balance between benchmarking funding and more targeted funding through the incentive trust funds created in HB 1.
- 5) What “counted” toward achieving the 55th percentile objective included the base appropriation, base adjustments (such as maintenance and operations for new facilities), and special initiatives funding. Trust Fund allocations and pass-through program funds to the institutions were also counted.

Issue 2: Operating Incentives

A. Trust Funds

Criticisms:

- 1) Too much funding was put into the trust funds relative to the base.
- 2) Funds become available only on the basis of institutional performance.

Discussion:

- 1) In fiscal year 2000-01, \$931.5 million was appropriated to the institutions and \$18 million (excluding student financial aid) was appropriated to trust funds. So, of the \$949.5 million appropriated for the institutions, more than 98 percent was appropriated to institutions' bases.

In fiscal year 2001-02, \$985.7 million was appropriated to the institutions and \$24 million (excluding debt service for facilities and student financial aid) was appropriated to trust funds. So, of the \$1,009.7 million appropriated for the institutions, more than 97 percent was appropriated to institutions' bases.

Trust funds are an important part of HB 1 and are targeted investments to implement the state's priorities for postsecondary education. Although relative to the total postsecondary education budget the trust funds do not amount to enormous sums, they do provide money for reform at the margin.

Guidelines for the trust funds for 2000-02 were approved by the Council July 17, 2000, and the presidents were involved in development of the guidelines.

- 2) The fiscal year 2000-01 Enrollment Growth and Retention Program funds are being allocated quarterly regardless of performance on institutional enrollment and retention goals.

Action Agenda Program and Workforce Training Program awards are based on single proposals from each comprehensive university and KCTCS, using broad parameters established by the Council but also requiring assessment and accountability reports to the Council.

The Capital Renewal and Maintenance Program and Equipment Replacement Program funds will be awarded in fall 2000.

Issue 2: Operating Incentives

B. Special Initiatives

Criticisms:

Some institutions did not know how institutional requests were assessed. Some institutions' requests were not funded.

Discussion:

- Institutions were allowed to request any item.
- Council staff reviewed each requested item and determined that some items could be funded from within an institution's base (or anticipated base increase), and others were eligible to be funded from the various 2000-02 trust funds programs.
- On October 11, 1999, the Council's Finance Committee held a budget hearing at which all institutions were given the opportunity to make twenty minute presentations to discuss their constituencies' interests in the Council's postsecondary education budget recommendation, including special initiatives.
- Council staff determined that a limited number of requested items needed additional funds and recommended those for special initiative funding (Agenda Item E-1 from the Council's November 8, 1999, meeting). There was never an indication of intent or commitment to fund one special initiative request from each institution.

Issue 3: Capital

A. Space Planning Guidelines

Criticisms:

- 1) The space planning guidelines did not adequately take into account the condition of existing space in determining the need for institutional space.
- 2) More flexibility is needed in implementing the 2000-02 Physical Facilities Trust Fund's Capital Renewal and Maintenance Program.

Discussion:

- 1) At its July 19, 1999, meeting, the Council adopted a set of space planning guidelines and use standards to assess space needs by type of institution and space category, e.g., classrooms, laboratories, and offices. The space planning guidelines and use standards are based on national standards and needs guidelines and address all categories of educational and general space, but exclude auxiliary enterprise facilities (housing and dining, hospital, and intercollegiate athletics).

Consistent data on condition of space was not available at the time the space planning guidelines were adopted. The Council staff subsequently developed, in the Kentucky Higher Education Comprehensive Data Base Reporting Guidelines for State Supported Institutions 2000-2001, clearer definitions for reporting the condition of space. These definitions will permit the condition of space to be included in the space planning guidelines.

- 2) For the 2000-02 biennium, the Council administers three capital project pools: 1) the Capital Renewal and Maintenance Program, 2) the Agency Bond Pool, and 3) an Equipment Replacement Program. The allocation of funds from two of these pools, the Capital Renewal and Maintenance Program and the Agency Bond Pool, is tied to lists of projects approved by the Council as part of its 2000-02 budget request. Institutions may change project priorities within the approved lists of projects but may not substitute projects that are not on the approved lists. Council staff continues to work with institutions to identify any real emergency projects that may have developed after the lists were compiled.

The state rewards good stewardship of existing physical resources by requiring institutions to participate as equal partners (dollar-for-dollar cash match) in the Capital Renewal and Maintenance Program. However, in the future, the Council may wish to recognize the need for additional institutional flexibility to match state funds using alternative funds sources, i.e., agency bonds or revenue bonds when an institution is responsible for paying the debt service.

Issue 3: Capital

B. Research Space

Criticisms:

- 1) The application of the space planning guidelines approved by the Council at its July 19, 1999, meeting may not reveal the full extent of the universities' need for new research space.
- 2) The universities should not have to fund any portion of the construction of new research space.

Discussion:

- 1) As noted in the July 19, 1999, agenda item, application of the space planning guidelines suggests that "some institutions need additional space in selected categories (e.g., more research laboratory space at the University of Kentucky) despite having excess space in total." Applying the guidelines led the Council to include the University of Kentucky's and the University of Louisville's requests for new research buildings in its recommendation for the 2000-02 postsecondary education budget.

One possible issue is that the guidelines equate research space with research laboratories only, excluding necessary support space (offices, meeting-rooms) dedicated to researchers' use in research buildings. Including the latter in an expanded definition might change the quantitative estimates of research space need. Council staff recommends that an estimate of research space needs be made using the expanded definition and that this estimate be compared with the one produced using the narrower definition.

The Council also should possibly examine how efficiently universities use the research space they have and how feasible retrofitting and refurbishing older research space might be. The quantity of space is only part of the discussion; quality is the other, particularly for the advanced research the University of Louisville and the University of Kentucky must do to reach their respective research goals mandated in House Bill 1.

- 2) The University of Kentucky and the University of Louisville will each pay 40 percent of the construction cost for the research buildings approved in the 2000 Regular Session. This is slightly less than the average of 43 percent reported for public universities in the *National Science Foundation's Overview: Scientific and Engineering Research Facilities at Colleges and Universities, 1998*. Recently, some of the University of Kentucky and University of Louisville benchmark institutions have funded or anticipate funding substantially more than 40 percent of their recent research facilities' construction costs. These institutions include Purdue University, the University of Minnesota, the University of Michigan, the University of Illinois, the University of Virginia, the University of Wisconsin, and the University of Cincinnati.